No. 22,188-A

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of

E. W. REYNOLDS COMPANY,

Bankrupt.

BEVERLY MCCONNELL, and OSCAR STROBEL, Trustee of the Estate of E. W. REYNOLDS COMPANY,

Appellants,

vs.

ESTATE OF W. H. BUTLER, Deceased, CERTAIN DEBENTURE HOLDERS,

Appellees.

On Appeal From the United States District Court for the District of Arizona.

BRIEF FOR CERTAIN DEBENTURE HOLDERS, APPELLEES.

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Jurisdictional Statement.

This is an appeal by Oscar Strobel, Trustee of the Estate of E. W. Reynolds Company, a Bankrupt, from a judgment of the United States District Court for the District of Arizona, entered in proceedings to review an order of the Referee in Bankruptcy of that Court.

The District Court had jurisdiction of the review proceedings by virtue of Section 1334 of the Judicial

Code. 28 U.S.C. Jurisdiction over an appeal therefrom exists in the above-entitled Court under and by virtue of Sections 1291 and 1292 of the Judicial Code, Title 28, U.S.C., and Section 24 of the Bankruptcy Act, Title 11, U.S.C. 47.

Statement of the Case.

In the said bankruptcy proceedings, the appellant trustee in bankruptcy filed objections to the creditors' claims of certain creditors, and for grounds of objection as to all of the creditors who are appellees herein, identically alleged as follows: "Allowance of the following claims on a par with the claims of other creditors herein is objected to, and your trustee respectfully requests that their allowance and payment of any dividends thereon be subordinated to payments of dividends to other claims of general unsecured creditors herein." Thereafter, said trustee filed a document entitled "Specification of Nature of Trustee's Objection to Debenture Claims", relating to the claims of the appellees herein. [Clerk's Record, p. 77.]

Said matter came on regularly for hearing before the Referee in charge of said bankruptcy. After a trial consuming a full day's time, in which oral and documentary evidence was introduced and the matter fully argued, the case was submitted upon written memoranda to be filed. After this was done, the Referee made his written Findings of Fact and Conclusions of Law. Based thereon, he entered an Order overruling said objections and ordering said claims to be allowed as filed as general unsecured claims on a parity with all other general unsecured creditors' claims in the proceedings. [Clerk's Record, p. 101.]

The appellant trustee filed with the District Court a petition to review said Referee's Order. The appellant trustee failed to request or arrange for the preparation or transmittal of any reporter's transcript, and, indeed, made no request nor arrangements for the transmittal to the United States District Court of any of the documentary exhibits which had been introduced into evidence. The same accordingly were not before the District Court on the review.

The Referee prepared his Certificate on Review, and filed the same on March 17, 1967. Notice of filing said Certificate on Review was filed on the same date and on said date served upon the appellant trustee.

Said matter came on for hearing before the United States District Court on Friday, April 7, 1967. Two days before that time, namely, on April 5, 1967, appellant trustee mailed to appellees and other interested parties "Objections to Referee's Certificate on Review and Request for Amendment Thereto", and filed the same with the District Court. For the first time therein, appellant trustee requested "that the Referee be by order of this Court required to certify a transcript of the evidence or a summary thereof." No funds or financial arrangements were ever made or offered with respect to said reporter's transcript, and, of course, appellant had allowed only one day for the Referee to prepare a further summary of the lengthy hearing assuming that the Certificate itself were not sufficient for this purpose. As a result, no transcript or summary were before the District Court on the review other than the Referee's Certificate on Review itself, which did contain a summary therein.

No motion or request for a continuance of the hearing set for April 7, 1967, was made by appellant trustee at any time.

Said matter was therefore heard by the District Court on April 7, 1967, and on May 2, 1967, the said Court entered its Order bearing date of April 27, 1967, that the Objections to the Referee's Certificate on Revew were overruled, and that the Referee's Findings of Fact, Conclusions of Law, and Orders appealed from were sustained.

The form of said Judgment was thereafter amended, at appellant's request, and entered as amended, on June 26, 1967. Notice of appeal therefrom was filed on July 3, 1967.

The Facts.

It has been held that where, as here, the Certificate of the Referee in Bankruptcy did not contain a summary of evidence, the Findings of the Referee are conclusive unless wrong on their face. *In re Runnymede Finance Co., Inc.* (C.C.A. 9th), 64 F. 2d 169, accord, *In re Burntside Lodge, Inc.,* 7 F. Supp. 785.

Thus, it is submitted that the facts set forth in the Referee's Findings of Fact necessarily set forth all of the facts upon the basis of which the District Court properly ruled, and which are available for consideration here.

It is to be noted, however, that the appellant's brief devotes considerable length to setting forth appellant's version of "The Facts". This version of the facts not only was not supported by the evidence before the Referee, but as above mentioned, was not brought by appellant before the District Court previous-

y other than as above described, and the introduction of facts at this stage on this appeal as thus attempted, t is submitted, is not appropriate before this Court.

However, in the event that for any reason the Court leems it appropriate to take up the factual matters as lescribed in appellant's brief, appellees hereby submit he following as more fully and accurately setting forth he facts and history involved:

The bankrupt, E. W. Reynolds Company was orignally founded prior to the turn of the century by E. W. Reynolds. Mr. Reynolds started out as a supplier of watch parts and repair materials to watchmakers. The business was incorporated as E. W. Reynolds Company in 1905, and gradually expanded its operaions into supplying and distributing watches, as well as watch parts, silverware, jewelry and, subsequent to World War II, small household appliances.

The Estate of Walter H. Butler, Deceased, is the largest single creditor of the above-named bankrupt, and Gladys Reynolds Butler is the Executrix of the Estate. Mrs. Butler is the widow of the decedent and one of the daughters of the company's original founder, E. W. Reynolds.

The business prospered and expanded both under Mr. Reynolds during his lifetime, and later under the direction of his son-in-law, the said Walter H. Butler.

The prosperity and expansion of the business brought its own problems. Its increased volume of sales required larger inventories and resulted in greater amounts of outstanding accounts receivable. The company secured the necessary capital to finance its increased inventories and added accounts receivable by

large bank borrowings. During the early and middle 1950's the company's need for working capital was so great that its bank loans went well in excess of $1,-000,000. This high was reached during its peak season, but even during its slack season the company found it difficult to get its bank loans below $500,000. This state of affairs brought its bank under criticism from federal bank examiners who took the position that this loan, at least to the lowest amount outstanding at any time during the year, constituted a permanent capital loan. Such classification of a loan would require the bank to place additional amounts on reserve. The company's bankers then advised the company that it would have to change its dividend policy, retain its earnings, or secure other sources of permanent capital investment, so that it would only use bank loans for short term peak season needs.

A temporary expedient to solve the immediate problems of the bank was developed. The regular bank used by the company was paid off by simply going to another bank and borrowing the required funds. This back and forth device was recognized to be only a temporary solution and retention of earnings, possible reductions in inventory, and tighter credit policies would have to be employed in order to bring the company's operations within its available capital.

During the early 1950's a good portion of the increased volume of business came from the sale of small appliances. However, these appliances were relatively large items from the standpoint of bulk, compared to the dollar volume of sales, and the profit margins were also low by reason of sharp competition. The company's operations had been conducted for many years in

downtown Los Angeles on 5th Street between Broadway and Hill, and the increased appliance business required the renting of a warehouse in the City of Vernon. This separation of facilities increased overhead costs, and during 1955 and 1956 plans were made and put into effect whereby Mr. Butler and his two sons provided the necessary capital to finance the construction of a combination of office, showroom, and warehouse, in an area now known as the City of Commerce. It was expected that by consolidating all of the operations, administrative, sales and warehousing, efficiency and savings would be realized. Part of this program was the result of recommendations made by a management consultant organization which was paid a fee of $22,724.41 during the fiscal year ending May 31, 1956, which constituted almost half of the net operating loss for that year. Other actions taken with respect to reduction in inventory and reorganization which occurred during 1956 contributed to that year's operating loss. However, these losses were anticipated, as it was expected a loss would be incurred with the moving expenses, the disruption in regular activity and certain reduction in inventory and other reorganization efforts.

As part of this reorganization plan, a policy that no dividends would be paid was adopted, and the adoption of this policy gave rise to the debenture exchange program which is the subject of the present appeal.

In 1947 the company had offered to sell some of its stock to employees on a stock purchase plan. Many of the employees, and most of the key employees, took up the offer and purchased stock, almost all by means of a small downpayment with the balance represented by a note secured by a pledge of the stock. It was ex-

pected that the dividends paid on the stock would take care of all or substantially all of their installment payment obligations as the company had a good record of earnings and a liberal dividend policy. Other principal stockholders, particularly members of the Butler family, had established standards of living based upon this generous dividend policy.

Thus, the increase in volume of business, the increase in costs of doing business, and the lower profit margins on a major segment of the sales volume all combined to put the squeeze on profits and increase the need for more working capital.

This was the situation facing the company's management and its bankers, with the result that a policy was established that no dividends would be paid until the company's working capital was built up out of profits to the point that bank loans would be needed only during the peak season to finance the added inventory needed for and the added receivables resulting from the Christmas season business.

It was realized that the establishment of the dividend policy would have a major impact on the many stockholder-employees who were depending upon dividends on the stock as the source of funds to meet their stock purchase plan payments. There were others whose savings were invested in the company's stock and who relied on dividends for part of their living expenses. All the key employees of the company, department heads, top salesmen, and the top echelon of administrative personnel were involved in the stock purchase plan and the company management were concerned about the many adverse affects the no dividend policy would have.

The two major effects on these stockholder-employees were, one, they would most likely have to default on their stock purchase contracts, and, two, they would be getting no return on their invested savings. A collateral problem existed because the company had a policy of purchasing the stock of deceased employees and as a part of the capital building program, it was no longer going to repurchase any stock from deceased employees. The company's stock, other than that owned by employees, was closely held by members of the family and had no market, thus a deceased employee's spouse would have no way of either raising money by a sale of the stock or getting any returns from the investment for an indefinite period in the future.

All of the considerations prompted the company's management to explore means of accommodating to the needs and desires of its many and important employees to maintain their loyalty and support and provide incentive for the future as well.

The device chosen to solve the problem was debentures. Debentures were capable of providing a given return per annum. Their value was fixed, and as evidences of indebtedness they had definite market value and were saleable. An additional attractive feature was that the interest paid on the debentures was a deductible expense for corporate income tax purposes.

As debentures appeared to provide the solution to the many problems which would arise between the company and its employee-stockholders upon the adoption of a no-dividend-policy, the company's management proposed a program of an exchange of stock for debentures coupled with a cancellation of all outstanding stock purchase commitments.

This exchange privilege was offered only to employee-stockholders and not to any of the corporate officers or members of the family group constituting the top management of the company.

There were 32 of these employee-stockholders and the largest single holding was 300 shares with a net equity of $43,470.00. The next largest equity was $25,000, and there were only six employees with equities between $25,000 and $10,000. The remaining 25 (out of 32) had equities of less than $10,000.

[Exhibit B to Supplement to Application filed October 31, 1956.]

The debentures to be issued were set up in series with none maturing before 1963.

The debenture-exchange program solved all of the company's problems with its employee-stockholders in such a way as to keep and maintain their loyalty and interest in the company and its future and forestall any complaint or feelings of animosity by these employees toward the company. The debentures were marketable and would give a current return at a reasonable rate on savings.

The company also would benefit as the interest paid would be a tax deductible expense, and though the debentures had maturity dates, they were far enough in the future to give the company an opportunity to improve its capital position by the retention of all of its earnings in the interim. Because of the marketability of the debentures, the company didn't have to concern itself with its responsibility to cash in any stock of deceased employees.

The annual cost of carrying this debenture issue was less than $15,000 per year (6% of the total amount of

debentures issued—$244,800, or $14,668) and after corporate income taxes the cost would be only about one-half of that amount. Year-end employee bonuses were much more than the cost of carrying the entire debenture issue.

Actually the debenture issue was a relatively small part of the entire reorganization plan. It was fully discussed and fully approved by the company's bankers who continued to renew loans in amounts between $500,000 and $1,000,000.

At this same time it was decided that a consolidation of the company's warehousing, showroom and office facilities would reduce the costs of operation. Mr. Walter H. Butler and his two sons, all in the top management group of the company and principal shareholders, purchased land and built a building in what is now the City of Commerce, specially designed with executive and administration offices, diamond vaults, air conditioned showrooms, and a warehouse area to house all the company's operations under one roof.

The plan of reorganization considered was adopted in 1956, as evidenced by the payment of $22,724.41 for management consultant fees and by the application to the California Commissioner of Corporations for the debenture exchange plan and the moving to the new place of business.

This was certainly not the course of action taken by a company on the verge of bankruptcy or insolvency.

It should be noted that as of May 31, 1956, the net worth or stockholders' equity was over two million dollars ($2,124,559.30). [August 31, 1956 Financial Statement.]

In spite of reverses, the stockholders equity at the end of the 1957 fiscal year was $1,754,046.00, and even at the end of the 1958 fiscal year the stockholders' equity was $807,381.

Unfortunately, this old line distributor was caught up in new merchandising methods in its field. Discount houses, and large merchandisers began buying direct, and on the other end of the line the retail jewelry merchant was expanding his easy credit sales and demanding longer terms from the wholesale distributors.

The discount operators put a squeeze on profits and the company's competitors were extending easy credit terms which had to be matched and this added to the company's need for more working capital. At the same time the company's bankers were tightening on the loans.

In an effort to improve the position of the company, Mr. Butler, the president, who had advanced substantial sums to the company, and his wife, who was also a substantial creditor of the company, agreed to accept preferred stock of the company in exchange for the amounts owed.

Following the completion of this exchange, which occurred during the 1959-1960 fiscal year of the company, the stockholders' equity was still $108,208.20. Indeed, as of January 31, 1961, the stockholders' equity was still $63,168.25; as of January 31, 1962, the stockholders had an equity of $29,148.35.

In continued efforts to accommodate to changing conditions and to continue the enterprise, further retrenchment action was taken. The Los Angeles operation was terminated and the company moved to its

Phoenix branch office, where it hoped to be able to operate at a profitable level.

Unfortunately, these hopes failed to materialize and finally, the company was declared bankrupt in 1963.

Questions Presented.

The only question presented before the bankruptcy trial court and the District Court on review was whether the creditors' claims of the debenture holders should in equity be subordinated in payment to the claims of other unsecured creditors, or whether they should be treated on a parity with them. No question was raised in the pleadings, at the trial, or before the United States District Court Judge as to whether the so-called debenture claims were "provable" in bankruptcy, or "enforceable", and appellees respectfully object to the raising of such additional issues for the first time at the present stage in the proceedings.

Summary of Argument.

The debentures are not proprietary interests; they are debts of the bankrupt. Equitable grounds for subordination of the debenture holders' claims are not present. There was no proof of the existence of any creditors in these proceedings to whose claims the appellees' claims should be subordinated legally or equitably. The Findings of Fact of the Referee should be sustained unless "clearly erroneous".

ARGUMENT.

I.

The Debentures Are Not Proprietary Interests; They Are Creditors' Claims.

The Referee determined that the claims of the debenture holders in fact were debts and were not proprietary interests. As a result, he properly denied the trustee's motion for subordination of their claims.

The Referee's conclusions were supported by a host of material factual criteria. The Findings of Fact numbered VIII, IX, X, XI, XII and XIII compel the conclusion which he reached.

The same in substance determined, first, that the capitalization of E. W. Reynolds Company was adequate and not merely nominal; second, that the employee-stockholders had no reason to believe that E. W. Reynolds Company was insolvent; third, that at the time of the agreement in October 1956, the employer-stockholders did not have nor possess any degree of control over management or the fiscal policies of E. W. Reynolds Company (and *a fortiori* had none once they become debenture holders thereafter); fourth, that the financial difficulties of E. W. Reynolds Company were not attributable to the creation of the debenture obligations; fifth, that after the creation of the debenture obligations the holders did not participate in the operation, ownership or management of E. W. Reynolds Company; and sixth, that the trustee had not proved nor did any evidence disclose the existence prior to May of 1957 of any presently outstanding claims of other general unsecured creditors.

Thus, unlike cases where subordination has been ordered, in the case at bar the facts established cumula-

tively that there was no proprietary interest on the part of the debenture holders and, on the contrary, the opposite was true.

> "Where there was nothing to compel a finding that bonds secured by the bankrupt's property must equitably be regarded as having been or as subsequently having become in effect a contribution to capital in favor of general creditors, the bonds could not be subordinated to the claims of general creditors on that theory . . .
>
> "The power of subordination necessarily must be measuredly and not blankly exercised. It must have a sound regard for the distribution results that will be produced to the creditors whose claim is being subordinated as well as to the other creditors. It should not operate to take away anything punitively to which one creditor is justly entitled in view of the liquidation finality and bestow it upon others who in the relevant situation have no fair right to it. It can, therefore, ordinarily go no farther than to level off actual equitable discrepancies on the bankruptcy terrain for which a creditor is responsible to the point where they will not create an unjust disadvantage in claim position and liquidation results."
>
> *In re Kansas City Journal-Post Co.*, 144 F. 2d 791, 795, 800.

With respect to the argument advanced by the appellant, we note that of the six classifications of situations set forth in the article "Equitable Subordination of Claims in Bankruptcy" by Herzog and Zweibil, upon which the appellant relies, only one such classification, namely, "Debt, Proprietary Interest or Capital Contri-

butions cases", is urged as a basis for subordination in the case at bar. We submit that the evidence introduced in the instant case by the trustee fails to establish grounds warranting subordination upon the said basis.

> "These cases actually turn upon the existence or non-existence of a debt, and not upon the question of whether the court will subordinate the claim." *15 Vanderbilt Law Review 93.*

> "Unfortunately, some bankruptcy courts have utilized the vague criterion of *Pepper v. Litton* (*i.e.* the 'Rules of Fair Play and Good Conscience') to determine the narrow question of whether the advance is in fact a loan or proprietary interest. A few opinions, however, have attempted to sketch applicable principles. Thus it has been said that it is not sufficient to find that the capitalization was inadequate, but that it must have been 'purely nominal'." 15 *Vanderbilt Law Review* 95; *Brown v. Freedman,* 125 F. 2d 151, 156.

Certainly in the case at bar, the facts fail to disclose that the capitalization at any time was "purely nominal". Even if a less restrictive test were applied, the evidence does not adversely establish any basis upon which the court can make a "factual determination as to whether the corporation has been provided with separate assets adequate to give it at least a reasonable business chance to carry out its asserted functions". 15 *Vanderbilt Law Review* 95. In fact, the evidence wholly supports the position of the debenture holders, for long continued operation was feasible.

Other applicable principles to be applied, according to said authors, include whether the essential nature of an advance is the cause of the eventual insolvency. Op.

Cit., at page 96. "On the other hand, if bankruptcy is attributable to causes other than that the entire life of the company from its inception was an insolvent operation, the loan is more likely to be sustained as such." Op. Cit., 15 *Vanderbilt Law Review* 96; *In re L. M. Alleman Hardware Co.,* 181 Fed. 810, 813.

In the case at bar, the trustee has failed to sustain the burden of proof to establish this criterion.

> "Another factor is time. The longer a corporation functions on its initial capital before controlling stockholders make advances, the greater the likelihood that the advances will be held bona fide loans." 15 *Vanderbilt Law Review* 96; *Arnold v. Phillips,* 117 F. 2d 497.

In the case at bar, the factual situation is not that of controlling stockholders, or even of stockholders who continue to be such at all; on the contrary, the debenture holders herein wholly lost their position as shareholders in the corporation upon relinquishment of their shares many years ago. It is submitted that the trustee failed to sustain his burden of proof on this factor either.

"Active participation in management may be one of a series of cumulative indicia of a proprietary interest." 15 *Vanderbilt Law Review* 98. The facts at hand establish exactly the opposite situation in this case.

The Court of Appeals for the Ninth Circuit was presented with the situation of an advance to a debtor corporation in consideration of an offer by a stockholder of his "net profits" in the development or sale of an oil lease. On these facts the court could find no joint venture, but merely a debtor-creditor relation due

to the absence of proof that the lender had any voice in the management of the venture or that he participated in the work. Accordingly, the court reversed an order of the Referee and of the District Court subordinating the claim, stating that it found "no evidence of any conduct on appellant's part which would make it inequitable for him to share with other creditors, or which estops him from so doing." *In re Pomoc Oil Co.,* 110 F. 2d 210 (9th Cir.)

II.

Appellant Failed to Prove by Clear and Convincing Evidence That Equitable Grounds for Subordination of Appellees' Claims Are Present.

Rather than lightly or automatically invoking subordination, this drastic remedy has been limited by the courts to nullify the effect of fraud that a creditor has committed.

The standard adopted by the U.S. Supreme Court for subordination requires:

> "The violation of rules of fair play and good conscience by the claimant; a breach of the fiduciary standards of conduct which he owes the corporation, its shareholders and creditors." *Pepper v. Litton,* 308 U.S. 311, 84 L.E. 291. "The rule is well summarized in *In re Bowman Hardware & Electric Co.,* 67 F. 790, 792, 794, as follows: 'Before a general creditor's claim against the bankrupt may be disallowed or its status lowered, it must appear that said creditor has been guilty of some act involving moral turpitude or some breach of duty or some misrepresentation whereby other creditors were deceived to their damage'." *Mc Donell v. Sampsell* (CCA 9th), 193 F. 2d 954

In denying subordination and ordering that the creditors' share on an equal basis, the court has declared: "The theme of the Bankruptcy Act is equality of distribution. Sec. 65a; *Moore v. Bay,* 284 U.S. 4; 18 ABR (NS) 675; 52 S. Ct. 3; 76 L. ed. 133. To bring himself outside of that rule, an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice."

Accordingly, the court required that there be proof of fraud in a transfer as a basis of granting priority over other unsecured creditors, and as a result, such proof being absent, denied the subordination sought as respects certain unsecured claims.

> *Sampsell v. Imperial Paper & Color Corp.,* 313 U.S. 215, 85 L. ed. 1293, 1298.

Similarly, the decision in *Hansenn v. Wingren,* 121 F. 2d 1011, 314 U.S. 683, enunciated and summarized succinctly in a headnote thereof, determined:

> "Where claims of creditors were established in corporate reorganization proceeding and were secured by lien on corporation's assets prior in rank to claims and liens of certain other creditors, and the plan was confirmed and consummated in part, and nearly three years after confirmation the corporation was adjudicated a bankrupt, and corporation's financial position on date of adjudication was substantially different from its position on date of confirmation of plan and creditors could not be placed in status quo, and creditors lost certain valuable rights by accepting plan of reorganization, creditors, were entitled to priority over such other creditors in the bankruptcy proceeding."

By analogy, the debenture holders in the instant case likewise changed their position by accepting issuance of their debentures many years ago; surrendered any authority to participate in the direction and/or control of the corporation involved; the issuance of their debentures was at a time when the corporation had a surplus, and was in actual payment, then and there, for the shares of stock which they surrendered; was entirely under the supervision and direction of the Corporation Commission of the State of California; and there was no fraud or withdrawal of assets occasioned by the resulting change of position above mentioned.

The facts in the case at bar are accordingly clearly distinguishable from the case decided in the year 1919 and relied upon by the trustee, namely, *Keith v. Kilmer,* 261 Fed. 733, and which forms the basis of the annotation in 9 ALR 1287. Contrary to the instant case, in *Keith v. Kilmer* the court pointed out that, "It is entirely clear that the transaction out of which the alleged contract grew was entered into, not for the benefit of the corporation itself, but for the benefit of certain stockholders. In brief, junior and minority shareholders, desired to buy out the senior and majority shareholders; and, having no money with which to buy, the parties agreed, not for the benefit of the corporation, but for the benefit of the trading shareholders, to have the corporation, in form at any rate, agree to buy and pay for a large part of the stock intended thus to pass ultimately from the seniors to the juniors, thus giving them control of the corporation and its offices with the emoluments thereof. The corporation was so-to-speak made an accommodation purchaser for the benefit of certain vending and purchasing shareholders."

Similarly, analysis of each case cited in the annotaion to said case of *Keith v. Kilmer,* also reveals that here were elements of moral turpitude with respect to he specific transaction involved. Such was not the tate of the facts in the case at bar. On the contrary, iere it was the corporation which initiated and carried orward the acquisition and immediate cancellation of he shares of stock from the debenture holders, and here is a total absence of evidence, much less the "clear ind convincing proof" required in cases of fraud, to establish in any way any unjust enrichment or inequiable conduct on the part of the debenture holders in the ase at bar.

III.

There Was No Proof of the Existence of Any Creditors in These Proceedings to Whose Claims the Appellees' Claims Should Be Equitably Subordinated.

The trustee failed to establish at the trial the exstence prior to May of 1957 of any claims now outstanding of other general unsecured creditors. [Finding of Fact No. XIII.]

For that matter, there was no proof offered or received in evidence at the trial on the Objections to Appellees' Claims either as to the existence or nature of any creditors' claims other than those of appellees, with the possible exception of the existence of the claims of former principals of the debtor, namely the Estate of W. H. Butler. With regard to the claim of said creditor, said creditor has never urged the subordination of the claims of appellees, although actively participating in the bankruptcy case.

Under the circumstances, where there has not been established the existence of any creditor or class of creditors who equitably are entitled to a priority over the creditors' claims of appellees, an indispensable element necessary for subordination is absent. Certainly, the appellant is in error in asking this court to speculate that there may be in existence claims of other creditors which equitably have greater rights than those of appellees; in fact, such was not proven to be the case. Only where there is clear and convincing evidence that denial of a priority to another creditor would work an injustice to him is subordination appropriate, and this obviously has not been established absent proof of the nature and existence of such other creditors' claim.

> *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 85 L. ed. 1293, 1298;
>
> *Consolidated Music Co. v. Brinkerhoff Piano Co.*, 64 F. 2d 884, 886;
>
> *First Trust Company v. Illinois Central R.R. Co.*, 256 Fed. 830 (aff'd 249 U.S. 615, 63 L. ed. 803, 39 S. Ct. 390, 243 Fed. 450, 252 Fed. 970).

IV.

The Findings of Fact of the Referee Should Be Sustained Unless "Clearly Erroneous."

Where, as here, there is no transcript or summary transmitted on review, the reviewing court must look to the findings of the Referee as conclusive of the facts unless on their very face they appear erroneous.

> "The findings of the Referee were conclusive upon the trial court unless they appear to be wrong on their face." *Matter of Runnymede Finance Co., Inc.* (C.C.A. 9th), 64 F. 2d 169.

In the case at bar, lengthy hearings were held before he Referee, at which witnesses were sworn and testiied and whom the Referee had the opportunity to oberve, documentary evidence was introduced, counsel had full opportunity to argue the matter and did so, nd the Referee prepared Proposed Findings of Fact, Conclusions of Law and Order, to which Objections vere lodged by the trustee's counsel. After careful onsideration, the Referee finally made and entered the Findings, Conclusions, and Order on file herein.

It is established beyond question that the Findings of Referee will not be disturbed on appeal unless "clearly rroneous".

> "Where the basic and undisputed facts are fairly susceptible of diverse inferences requiring different conclusions, the determination made by the trier of fact is conclusive on review unless that finding is 'clearly erroneous'." *Hoppe v. Rittenhouse* (C.C.A. 9th), 279 F. 2d 3, 9.

The foregoing holding of the courts is directly in accord with the applicable Federal Rules of Civil Procedure and with the applicable General Order in Bankruptcy.

> *Rule 52(a) of Federal Rules of Civil Procedure; General Order in Bankruptcy 47.*

Conclusion.

The appellees do not hold "proprietary interests". On the contrary, the debentures which were issued and which form the basis of their claims, were issued for a concurrent consideration, and the transaction was a fully completed and executed one, not an executory agreement. The debentures were negotiable. To a sub-

stantial extent, the present creditor claimants are not those to whom they were initially issued, but are their heirs, successors, assigns, or transferees. There was no fraud in the creation or maintenance of the claims of appellees, and there is no inequity in treating them on a par with other creditors; on the contrary, to do otherwise would result in a gross inequity. Where the debentures, and accordingly cannot be said to have arisen in current cancellation of shares of stock which debenture holders formerly held, where the rights of creditors (if any) arose subsequent to the issuance of the debentures and accordingly cannot be said to have arisen in reliance upon any financial statement or condition whereby there was reliance upon the existence of any capital stock purportedly held by appellees or their predecessors, and where the debentures were issued under the supervision, control, and authorization of appropriate public authorities, it is submitted that the equitable principles necessary for invoking subordination are not present. Accordingly, subordination should be denied, the creditors' claims allowed, and the Order of the District Court and Referee sustained.

Dated at Los Angeles, California, January 31, 1968.

Respectfully submitted,

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Certificate of Counsel.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

Haskell H. Grodberg